

No. 15,072

United States Court of Appeals
For the Ninth Circuit

PEGGY LOU RIKER and FRED A H.

GRASSMEE,

Appellants,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

BRIEF FOR APPELLANTS.

HOWARD B. CRITTENDEN, JR.,

One Eleven Sutter Street,
San Francisco 4, California,

Attorney for Appellants.

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BRIEF FOR APPELLANTS.

This is an appeal from a decision of the United States Tax Court in the consolidated cases of Freda H. Grassmee, and Peggy Lou Riker, under 26 U.S.C.A. 7482.

The defendant, Freda H. Grassmee, was employed during the taxable year of 1948 and 1949, receiving a salary from her employment (R. p. 140). She donated her entire income to her Church, using the Church form #399 in evidence (R. p. 140), that the money was to be used exclusively for religious purposes of the Church. Notwithstanding the wages withheld, the Commissioner determined a deficiency against the taxpayer for \$176.53. The petition to this deficiency was

filed with the United States Tax Court, seeking a re-determination, contending that 15% of the income was permitted as a deduction under Section 23(o), Internal Revenue Code, her entire wages having been given to the Church for religious purposes.

On September 1954, two months prior to the Tax Court Trial, the Commissioner filed an amended answer setting forth that Mrs. Grassmee on her return for the taxable year 1948-1949 claimed two (2) exemptions, one for herself and one for her mother, and contended that because Mrs. Grassmee's mother lived with her in the apostolic group of the Church, the petitioner was not entitled to take an exemption for her mother. The mother was eighty-four or eighty-five years old, (R. p. 141), and the mother lived with the taxpayer when she joined the Church, and the taxpayer was then supporting her (R. p. 141). During the entire years of 1948 and 1949, the mother lived with the taxpayer, and moved with her from the Church group in Los Angeles to the Church group in San Francisco. Both the taxpayer and her mother lived as a part of the apostolic society, and were supported by the Church during both these years.

The appellant, Peggy Lou Riker, with her husband had been in partnership in a drug store with his parents. The partnership was dissolved, and the taxpayer and her husband took the fixtures from the business and made a cash settlement with the parents and joined a group with the Church in San Bernardino. The group worked together to set up the project of the Church (R. p. 144). During the years involved from

September 1947 to January 1948 all of the gross receipts from that group in the Church project known as "Your Foods Fountain" was turned over to the Elected Delegates Committee of that Church (R. p. 145). The entire gross receipts of that Church group were transmitted with the Church form #399 which stated that the money was transmitted to be used by the Elected Delegates Committee of the Ecclesiastical Society of Christ Church of the Golden Rule for religious purposes of the Church.

The taxpayer was known as the "project manager" of the Church group (R. p. 145), which involved duties of instruction and teaching others in their ecclesiastical works and studies (R. p. 146); Canon Law #22 (R. p. 53). Materials and supplies were purchased from the project bank account, and the group were reimbursed through the Elected Delegates Committee (R. p. 147). All bills and receipts of expenditures were required to be submitted to the Committee and the group were reimbursed to that extent (R. p. 147).

The taxpayer lived with a group on a ranch a short distance from San Bernardino (R. p. 150). The group at San Bernardino were part of the larger apostolic society living group of the Church (R. p. 155). The group lived from revolving funds provided by the Elected Delegates Committee (R. p. 117). The student minister training project at San Bernardino was maintained by the Church for the purpose of making it possible for the student ministers to express and live in their daily activity, the teachings of the Church (R. p. 115).

The Church has congregations and its teachings (see declaration of faith R. pp. 20-22, tenet, R. p. 30, purpose, R. pp. 31-32, duties, R. p. 55), which include the concept that mere talking about Christ's teachings is not sufficient, but it should be seriously lived by men (R. pp. 110-111), and the teachings of the Church include that Christ's teachings should be lived and applied to everyday activity; that giving does not impoverish nor does withholding enrich and most of this world's ills are suffered from selfishness and greed and desire to get something for oneself rather than to give all one has to glorify the Creator. Giving with no thought of return brings back to the giver all that he needs. Those in the Church study and practice this everyday application of Christ's teachings regardless of what they did. The ministry of the Church is the bringing to the public so that they can see how it actually works and the Church has Student Minister Training Projects to let the public witness the daily application of Christ's teachings in whatever the group happens to be doing (R. pp. 110-113).

The Church's ministry is to bring to the world, a way that they would be able to see how it works. The Church has a cross-section of projects for this purpose to promulgate and spread the teachings of the Church (R. p. 113). Some of the Church members live at home and these congregations are similar to other Churches. Others take the Church's teachings as their life's work, and live in the Apostolic Society and study and learn to live this way of life to be teachers and way-showers as was Jesus Christ (R. p. 114).

The various living groups of the Apostolic Society of the Church are Student Minister Training Projects (R. p. 114), which were selected by the Church primarily for the purpose of more widely dispersing and promulgating these teachings by having the public come in contact with the student ministers in training (R. p. 116), and to train the students to spread these teachings to the public (R. p. 119). Some are run at a financial loss (R. p. 120), the sole consideration for maintaining or continuing a project was whether or not it was serving the purpose of promulgating the Church's teachings and its ministry (R. p. 120). They have ordinary theological work in the ministry training and the laboratory work, where they take the teachings and interpret and apply them into whatever walk of life or activity they may be asked to serve (R. pp. 120-121).

The Elected Delegates Committee is a temporal agency of the Church for operating and handling the property of the ecclesiastical government, after the ecclesiastical government has designated what it shall be used for and where. The ecclesiastical government, not the Committee, makes these determinations. The ecclesiastical government determines who are members and how much the Committee shall provide or pay to support any group, and the Committee is responsible to carry them out (R. p. 125), (Canon Law #12, R. pp. 41-44).

Where one project makes more money from the application of Student Minister activities and gifts, that group does not live better than another project

(R. p. 126). The entire Apostolic Society has a single budget for living costs set by the ecclesiastical government (Canon Law #12, R. pp. 41-44), and all are treated equally (R. p. 126). All of the funds come into the main Treasury and living expenses are paid by the Committee according to the budget set (R. p. 126). When there is a profitable period, it does not mean a better living standard for those in the Apostolic Society as that is not in the purpose of the ministry (R. p. 127). When there is a deficit, the deficit to meet the budget for living comes from sale of property the Church owns for its religious purposes (R. p. 126).

All of the earnings of the various groups as a by-product of the Student Minister Training and the Church activities went to the Church (R. p. 137), together with gifts and donations of individuals. Each project had its own revolving fund and its own living budget set by the ecclesiastical government (R. p. 137), and all groups had the same living standard, so that if one lived on a ranch such as that near San Bernardino, and raised their own food, that was taken into consideration (R. p. 137). During 1948 and 1949, the Committee of the Church filed its informational return, Form 990 as an exempt organization should (Exhibits 2 and 4), and a Form 1065 return listing the names of each member (a total of 575 in 1948, and 605 in 1949), (Exhibits 3 and 5), and the individual members during each of the years filed by family group listing the pro-rata share as a dividend in strict conformity with Rev. Code Sec. 101, Subdivision 18, applicable to Apostolic Religious Societies. Examples appear in the record as Riker returns (Exhibits 6 and

7), and Grassmee returns (Exhibits 11 and 12). Each shows the number in the taxpayer's family and (for example 1948) 1/575 interest in \$217,001.54 net income of Elected Delegates Committee, as not received as a dividend but reported under Section 101(18) per person in Association, \$377.39; 2 persons, \$754.78. The taxpayer stated in each return by a sheet attached the amount contributed to the Church, and since all contributions were included and reported as part of the Apostolic Society income, taxpayer would be taxed twice on the same income by reporting it as wages and also as a dividend, for this reason only the dividend or pro-rata share of the Apostolic Society was reported (R. pp. 86-87 and Exhibits 6, 7, 11 and 12).

At the Church project at San Bernardino, between 12 and 17 lived on the ranch as part of the Apostolic Society (R. p. 146), and they conducted the Student Minister Training Project of Your Foods Fountain (R. p. 146). The old church corporation having fallen into the hands of the Bankruptcy Court, the trustees in bankruptcy collected the Church's gifts and services of its members after the adjudication. The Judge ordered the trustees in bankruptcy to cease operating the Church and these trustees claimed the property used by these members (R. p. 128). Out of this grew the agreement, set forth by the Petition and Order of May 1947 (Exhibit 9), and finalized by the Petition for Approval and Confirmation of Sale of Personal Property in July 1948 (Exhibit 10).

By that series of negotiations and agreements between the Trustees in Bankruptcy and the Church

Committee, the Committee made a note for \$1500 to buy the property and subsequently paid the note (R. pp. 129-130). The Elected Delegates Committee finally sold the property of that project in 1949 and the Committee received the proceeds of sale (R. pp. 130, 148).

Because of this difficulty and it was no longer suitable for a Church project, the activity was closed as a Church project in January 1948. Mrs. Riker operated the fountain as a partnership, changing partners from time to time while the Committee tried to sell the business (R. p. 129), and for the most part her partners were relatives (R. p. 149), until the final partnership was an intended purchaser (R. p. 151). During the partnerships it was run as a private business (R. p. 150), but Mrs. Riker gave all her share of partnership income to the Church. This delay from January 1948 to July 1949 arose because of the cloud and defects in the title to the equipment (R. p. 151 and 156), and not until early 1949 was the sale affected (R. p. 152).

It should be noted Mrs. Riker's taxable year ran from September 1947 to September 1948 and that she showed in her return all the receipts of that Church project and showed she operated it but claimed she was taxable only on her proportional share of the Apostolic Society's income, (including donations and not deducting costs of living designated "Student Minister Maintenance").

Although the gross receipts were delivered by her as head of the San Bernardino group to the Elected Delegates Committee on gift forms #399, the Committee

reimbursed the revolving funds for all operating expenses of the project. The Committee purchased the Trustee in Bankruptcy's claim to the fixtures, etc. of the project "Your Foods Fountain". Mrs. Riker was but one of a dozen whose efforts went into the activity. The net income is thus the sum total of those separate items, if we view it as a taxable business:

(1) Use and exhaustion of the capital such as fixtures, equipment and money to operate furnished and owned by the Elected Delegates Committee.

(2) Labor of some 12 to 17 persons, all part of the Apostolic group who worked in this project as part of their religious work, intending any by-products of their labors to go to their Church as it did, for advancement of their religious crusade.

(3) Wages of management which was the product of Mrs. Riker's efforts, which she intended to donate and for it to go to her religious crusade as it did.

After it was no longer a project there were still elements of income of any business.

(1) Return and risk of the investment and exhaustion and depletion of physical property.

(2) Personal services of those working in the food fountain.

The partnership returns show very small volume of business and that the partners divided all the income without allotting or paying any part for the use of the investment or depletion of the physical assets owned by the Church Committee. Mrs. Riker gave all she received from these partnerships to the

Church Committee, as well as the product of her labor and there was no segregation intended or attempted as all went to the Church for its religious purposes.

The Riker return contained an error whereby she over-reported actual gross receipts and therefore net of the food fountain operation by \$969.26 (R. pp. 155-158), all of the gross receipts being deposited to the account of the Elected Delegates Committee, and while it was operated as a Church project demonstrating Christ's teachings (R. pp. 155-156) and operated through the efforts of a dozen student ministers on that project as a ministry of their religion (R. p. 156). The net income of the business as shown in the return had a \$2,000.00 omission of materials and supplies after the project was closed and prior to the sale by the Committee being effected. This testimony was not controverted and the Commissioner did not claim to have audited the accounts or record and he made his determination of deficiency on the basis of the contention that the income of the project, including the return and risk on the investment of the Committee—exhaustion of assets owned by another, efforts and labor to produce this income by those in the ministry who were not paid or compensated by the taxpayer were taxable to Mrs. Riker alone as an individual and she could not deduct anything as a donation to her Church.

CHURCH ORGANIZATION.

Christ's Church of the Golden Rule was organized along the conventional lines. It had an organic law which it called a Church Constitution and Canon Laws (Exhibit 1 in evidence, appearing in the record, pages 20 to 67). Ecclesiastical matters are vested in the ecclesiastical head, the Senior Elder, and the Board of Elders, a legislative body, and the College of Pastors. Final ultimate control vested in the Convention that had full power to remove any official and make any final act. It could be called by either the Senior Elder or by 25% of the Church members and convention members are elected by the membership.

Property and income of the Church are held by Temporal Agencies solely for religious purposes. The guarantees and safeguards that this property, money and income could and would be used solely for these purposes are clear, numerous and effective.

(1) All officers and members of such an agency must be ecclesiastical members subject to the discipline of the Church (Const. VI, R. p. 26), that is, members entitled to positions of trust and confidence by reason of their religious beliefs alone (Canon Law 13 (8), R. p. 48-49).

(2) All temporal agencies must hold a charter from the Church government (Const. Art. VI, R. p. 26-27), one of the conditions of which is that it is subject to the Church laws (Canon Law 4 & 5, R. p. 34-35). Any transaction involving \$10,000 or more must be approved by the Senior Elder whose determination is whether the transaction is calculated to

reduce or lose property subject to religious uses *and* whether the transaction will carry out the religious purposes (Canon Law 6, pp. 35-36). If any temporal agency does or suffers to be done anything that materially impairs the ability of the temporal agency to act for the Church or impairs its property for religious purposes, then (1) the Senior Elder, or (2) the Advisory Board, or (3) the Church judiciary on its own motion can suspend the powers of the Temporal Agency, thereupon the Church Judiciary shall designate a Temporal Agency to take possession of its property and upon notice the Church Judiciary shall have a hearing and decide the merits and who shall take the property as successor under the religious trust (Canon Law 7, R. p. 36-37). If the Senior Elder determines any charter is violated or Canon Law violated, he can suspend the charter, or the Church judiciary has this power (Constitution Art. VI (4), R. p. 26). If either the Senior Elder or Advisory Board find any property of a chartered agency of the Church is not being used according to the religious dedication, the property can be transferred to another temporal agency as in the Canon Laws provided (Const. Art. VI (5) R. p. 27). The Church judiciary has final determination in such matters (Const. Art. VI (6) R. p. 27).

(3) All property of the Church is held under an express trust for the benefit of the ecclesiastical organization (Const. Art. VI (7) R. p. 27-28 and Canon Law #3, R. p. 33) and the ecclesiastical matters are all important (R. p. 33).

(4) All property acquired by the Church or any of its activities or groups must be used exclusively for the religious purposes (R. p. 37-38), and all gifts and transfers are bona fide gifts to the Lord's work, unless there are conditions or understandings in writing approved by the ecclesiastical government. The Canon Law 8 (R. p. 37-38) specifically defines this consent shall be given only if the condition or understanding or promise will tend to carry out the religious purposes and such written condition or understanding or promise is necessary to carry out those religious purposes. Consent shall be withheld if such condition, understanding or promise in the discretion of the ecclesiastical head is likely to impair the religious purposes or subject other property subject to the religious purposes to undue risk or hazard. This Canon Law states the policy of encouraging gifts of real property to be subject to the condition that it be used solely for religious purposes.

(5) Gifts having a condition to maintain or support the donor or for support of any individual are prohibited (Canon Law 9, R. p. 39).

(6) Canon Law #10, (R. p. 39-40), specifically provides no money, income or property shall accrue to the personal profit or benefit of any person, persons or shareholders but all income of any group, project or temporal agency shall always be used for religious purposes and no amendment of the Canon Laws and no instrument under which any gift or conveyance is made shall permit any person to have any proprietary rights in any income. No Temporal

Agency shall ever issue any stock or certificate for payment of any income to accrue to the benefit of any individual or stockholder.

(7) Canon Law 11, R. p. 40-41 prohibits the use of any property to influence legislation or for propaganda. It prohibits any gift, conveyance or acquisition under which property may be used for such prohibited purposes.

(8) The personal profit from the Lord's purse is specifically prohibited as is any profit to any person to commercialization from property subject to religious trust (Canon Law 12, R. p. 41-43). No salaries, wages or compensation can be paid to any person for work, studies or effort in carrying out the religious purposes and all such services are bona fide gifts unless the person subject to the Canon Laws, (that is members and officers), has an express contract in writing with the person, group or organization defining the compensation and the writing is duly approved by the ecclesiastical government who shall not approve such a writing unless it is determined the compensated services are within the religious purposes and necessary to carry out those purposes (Canon Law 19, R. p. 51-52). Even expenses of travel, etc. cannot be paid without a Church official determining the sum is necessary and it will carry out the religious purposes (Canon Law 12, (1), R. p. 41).

(9) To meet the material needs of those persons, their families, and dependents who dedicate their work, services and studies to carry out the religious purposes, the Apostolic Society form of living is se-

lected as the means to accomplish these results within the doctrines of the Church (Canon Law 12, R. p. 41-42).

The apostolic form is that used by the early Church and is described in The Book of Acts.¹ The various members and their families live in groups and the Church provides such of their necessities as it sees fit. Those in the group donate so much as they wish to the Church (lay it at the feet of the Apostles). The Church has a common community Treasury for these needs. Peter, the Apostle, stated to Ananias and Sapphira that they were not required to give anything, but having sold some property it was wrong to give part and lie about the sum received from the sale.²

(a) Canon Law 12 (2) provides for the common community Treasury. The Church government had designated the Elected Delegates Committee as the temporal agency to handle this common community Treasury (R. p. 103).

(b) The ecclesiastical government designates how much is necessary (Canon Law 12 (4), [R. p. 42] and R. p. 117, 118, 125, 126) for the common community Treasury to carry out the religious purposes through

¹Acts 2:44-7; Acts 4:32-7.

In the New Testament published by St. Anthony Guild Press, Paterson, N. J. at page 325 appears a footnote to Acts 2:44 wherein it is stated the early Christians held the property in common. "In common. All were ready to help the needy, and as occasion demanded, they sold their possessions to do so: this spirit of fraternal charity is widely different from modern Communism."

²Acts 5:1-11.

the Apostolic Society form of living. Thereupon the various temporal agencies are authorized to make available money or property as a religious purpose up to the amount so determined.

(3) From among the facilities owned or controlled by the various temporal agencies, the ecclesiastical organization specifies those to be used for living accommodations and the temporal agency is authorized to use such property as a religious purpose as directed (Canon Law 12 (5), R. p. 42-43).

(d) Only the ecclesiastical organization can determine the amounts for benevolences.

(e) Only the ecclesiastical organization can designate who, including those not Church members, can be fed, lodged or supported by the temporal agency as a charitable or helpful act in illustrating the teachings and purposes of the Church.

(10) Canon Law 17, (R. p. 50) provides there shall be no legal obligation for giving or paying money as a condition of office, or membership. Canon Law 18 provides there shall be no financial liability or property rights accrued by reason of Church membership or office.

(11) Canon Law 20 (R. p. 52), specifically states no person has any right, title or interest to any Church property by reason of membership or office. It states all property shall be used exclusively for religious purposes of the Church.

(12) It is made a specific offense triable before the Church judiciary for any person subject to the

Church disciple to attempt to divert property of any temporal agency from its religious uses or misuse such property, contrary to the doctrines of the Church.

(13) The Church judiciary is given full and final jurisdiction in all Church matters, including property. Any person in the Church may invoke its jurisdiction. Only in disciplinary proceedings may its punishment be changed by the Senior Elder, to reduce the punishment or grant clemency (Canon Laws 30 to 37, R. p. 58-67).

The Tax Court stated in its decision (R. p. 95):

“The Church has no church buildings. Its principal reliance is on having its members live in a manner exemplifying Christ’s teachings, particularly by living in a selfless manner. Its student minister training projects, while engaging in commercial activities, were designed to permit the public to witness the application of Christ’s teachings to everyday life. Thus the very means chosen by the Church to attain its spiritual purposes involve engaging in commercial activities through its principal temporal agency, the Committee . . .”

QUESTIONS ON APPEAL.

(1) Whether related income during 1948 and 1949 of a Church from activities of student minister training and spreading of the Church’s religious teachings, which activities produce revenue, and which revenue by the organic Church law must be used for religious purposes only, and are so used, disqualifies the organ-

ization from exemption under Int. Rev. Code, Sect. 101, Subdivision 6.

(2) Whether Christ Church of the Golden Rule, and its principal temporal agency, The Elected Delegates Committee of the Ecclesiastical Society of Christ Church of the Golden Rule are exempt organizations and gifts to them by the appellants in 1948 and 1949 are deductible under Section 23 (0) Internal Revenue Code of 1939 up to 15% of income.

(3) Whether appellant Grassmee is entitled to dependency exemption of her dependant mother for 1948 and 1949.

(4) Whether appellant Riker is taxable for the income of a related religious activity of the religious apostolic group of which she was but a member and local official and which income was the product of the service of that group and of the property, fixtures and equipment bought and owned and later sold by the Church committee.

(5) Whether appellant Riker as a member of an apostolic religious society with a common community treasury who files its return as such under Rev. Code 101 (18) and whose members file their tax return showing the distributive share, whether received or not, is taxable upon more than her distributive share.

(6) How a member of a religious apostolic society with common community treasury which members and organization report the organization's income under Internal Rev. Code, Section 101 (18), are taxable; whether for the amounts received and remitted to the

group or upon the proportional distributive share, whether received by the member or not.

(7) Whether appellant Riker is taxable for actual net income of her religious group paid to her Church, or for some \$2,969.00 additional reported by mistake but not actually received by her or her Church.

The Grassmee case involves solely, (1) whether she is entitled to 15% deduction under Section 23 (0) for the money given to her Church with Church form No. 399 stating it was for religious purposes (point on appeal No. 2), and (2), whether because she lived in the Apostolic Society with her dependant eighty-four year old mother, she should file her return as a member of a family group, including in her return her distributive share and that of the others in her family unit and listing each exemption of each person in the family unit or whether each person in the family group, whether an aged mother or a small child, each should file separate and distinct returns showing but one share or dividend under Section 101 (18) and each claiming only his or her individual exemption (point on appeal No. 3).

The Riker case raises numerous questions of income tax under Section 101 (18) on apostolic religious societies:

(a) Whether the spiritual head of a group is taxable for any revenue arising as an incident to the ministry of the group from the group's efforts, using the Church's property, and all the gross receipts being deposited forthwith to the Church and expenses connected therewith being paid by the Church. This

is point No. 4 in which the Commissioner seeks to charge Riker income tax on the income of the Church project at San Bernardino.

(b) Whether Mrs. Riker who made a return of the fractional shares of the Apostolic Society under Section 101 (18) for both herself and her six year old daughter is taxable on more than this by reason of her religious office or membership in the Church or whether she is taxable for income of this religious society which she handles for the group, in addition. This is question 5, 6 and 7.

(c) Whether a person in an apostolic religious association:

(1) Reports income of the individual donated to and reported as part of the gross income of the society upon which all of the members are taxed a proportional amount; and deducts a maximum of 15% of that donation to the Church under Section 23 (0). This results in double taxation, first to the party earning it; then to the various individual members including this same taxpayer, as part of their distributive share.

(2) Reports only the proportional income of the association, which includes the group income from donations, and pays taxes thereon under Section 101, Sub. 18, and whether the proportionate share of the donations taxed to each are subject to the 15% deduction of Section 23 (0).

SPECIFICATION OF ERROR.

Appellant Grassmee specifies as error the refusal to allow her deductions in either 1948 or 1949 for gifts to her Church up to 15% for adjusted gross income under Section 23 (0) and the disallowance of the exemption of her dependent mother in the returns by family group wherein she listed the income of herself and eighty-four year old mother and took the exemptions of both in the group for whom she made a return.

Appellant Riker specifies as error the taxing her as an individual for all the income arising as an incident of the religious activities and ministry of the San Bernardino group of whom she was the spiritual head and teacher which income was the product of the efforts of the entire group whose living expenses were paid by the Church, not her, and which group received no remuneration, and which income was the product of the investment of and owned by the Church and which income included exhaustion (depreciation) of equipment owned by the Church. Appellant Riker specifies the Commissioner erred in refusing any deduction under Section 23 (0) for the product of her labor which the Church received.

Appellants specify as error the holding of the Tax Court that their Church and its temporal agency, The Elected Delegates Committee, were not organized and operated exclusively for religious purposes, no part of the income inuring to the benefit of any individual or shareholder, and no part of whose income is used for propaganda or to influence legislation, because:

stantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation.

to an amount which in the above cases combined does not exceed 15% of the taxpayer's adjusted gross income . . . ”

It is the policy of the law to encourage support of religious, charitable, scientific, literary, and educational organizations by private donations. Not only are these organizations encouraged and developed to the end that the general benefit of individual efforts along these lines accrue to the public but also the encouragement of the individual taxpayer to partake in the worthy causes it encourages.

The Courts have construed these provisions of the law liberally. A taxpayer having in good faith made a donation to a religious organization or for the use of such an organization is not to have his or her deduction subsequently denied and suffer a deficiency assessment for mere technical reasons or because the taxing authorities take a restricted view of a particular religion or religious practices of the beneficiary of the donor's bounty.

In actual practice, the taxing authorities disallowance of this deduction has a severe crippling and destructive effect on any religion. This power of the taxing authority can be the basis of discrimination within the First Amendment of the United States Constitution, for private contributions and donations are the life blood of any religion's activities, its power to expand or even survive. Few but the most devout

will continue to support a Church knowing there is certain to be income tax audits, income tax trouble and deficiency assessments if they so much as give financial support to the religion of their choice. Nothing is calculated to discourage financial support of one's own religion than a knowledge that the mere giving and contribution is certain to entail a careful audit of one's return, conferences with the taxing agencies and certainty of a deficiency assessment. How much stronger this effect is as a discrimination and detriment, to the particular religious cause at bar where the concept of Christianity involves the living of a selfless life like Christ, and the donor and contributor such as Grassmee and Riker who gave all their money as they received it to their Church. The very concept of the apostolic religious form of living which is recognized by Congress and regulations of the Commissioner of Internal Revenue, are struck a deadly blow when those living in this recognized form of religious activity are singled out for assessments, disallowing their gifts to their Church, which gifts are included in the income of the group and the pro rata share thereof reported and taxed as income to each member of the group. The contributors and donors are ascertained from their Church's records and returns and penalized by income tax assessments for their religious beliefs and zeal in advancing their religious crusade.

The policy of the law is contrary to this strict view and the Constitutional right of religious freedom abridged, infringed and made the subject of administrative action and personal liability.

A.

This provision by statute excepting gifts and donations is begotten from motions of public policy and is not to be narrowly construed.

Helvering v. Bliss, 293 U.S. 144, 55 S.Ct. 17, 79 L. Ed. 246;

Harrison v. Barker Annuity Fund, (CCA-7) 90 F. 2d 286;

Cochran v. Comm'r, (CCA-4) 78 F. 2d 176;

Roche's Beach Inc. v. Comm'r, (CCA-2) 96 F. 2d 776.

This section is to be liberally construed, it being remedial in character.

Seasongood v. Comm'r, (CCA-6) 227 F. 2d 907.

A gift to an irrevocable trust which includes charitable purposes for beneficiaries, kin of the donor (preference directed to worthy descendent's of the donor's father), is a deductible gift.

Schoellkopf v. U.S., (CCA-2) 124 F. 2d 982.

A gift to the donor's grand Army Post is deductible. The character of the donee corporation is to be determined by its articles which was a non-profit corporation intended for relief of its members, etc.

Duffy v. Pitney, (CCA-3) 2 F. 2d 230.

Voluntary gifts to an unincorporated association whose purposes was to pay pensions to Gimbel Bros. employees, pay for life insurance of their employees, extend relief to those employees, and provide certain

scholarships, are deductible gifts. It does not defeat the exemption because the charity is restricted to a class.

Gimbel v. Comm'r, (CCA-3) 54 F. 2d 780.

A gift to an association is none the less deductible because it is for awards to citizens. The motive of the gift is the test and it is still charitable though it extends to both rich and poor.

Bok v. McCaughn, (CCA-3) 42 F. 2d 616.

A gift to World League Against Alcoholism is deductible as an educational purpose though it advocates, collects and disseminates information about prohibition and use of alcohol. The Court points out a university may have a professor who advocates controversial matters and a library can contain books of a controversial nature, but neither are less educational thereby.

Cochran v. Comm'r, (CCA-4) 78 F. 2d 176.

A gift to an unincorporated association of members of the donor's family and the association made gifts to indigent individuals who were old family retainers (\$2257 given in year to 9 individuals) is deductible.

Havemeyer v. Comm'r, (CCA-2) 98 F. 2d 706.

A gift is deductible under Section 23 (o) when made to a fund organized and controlled by a non-exempt organization, where the purpose of the fund is within the section. This section is based on public policy to encourage donors for the listed purposes.

Faulkner v. Comm'r, (CCA-1) 112 F. 2d 987.

A gift is deductible when made to the League for Industrial Democracy which does research, makes lectures, debates and discussions and promotes pamphlets and books concerning economic and social problems. The fact the donee organization may be like or unlike a political party does not remove it from its educational work and education is the imparting and acquisition of knowledge, mental and moral training not restricted to the narrow concept of instruction.

Weyl v. Comm'r, (CCA-2) 48 F. 2d 811.

The fact that the donor receives an incidental benefit from a trust to which the gift for civic and charitable purposes was made does not defeat the exemption.

Johnson v. U.S., (DC-Tex.) 8 Fed. Supp. 842.

A gift is deductible under Section 23 (o) when made to I AM reading room for religious, educational and charitable purposes of that religious movement.

Potter v. U.S., (DC-Ill.) 79 Fed. Supp. 297.

A gift to Hamilton County Good Government League is deductible under Section 23 (o) though the donor was a principal backer and officer in it, the organization sponsored political candidates, sponsored and opposed various legislation. The Court pointed out only 5% of the time and effort went to propaganda which it defined as enlightening people in matters of politics and the substantial activities were

within that section. The Court in determining the gift deductible held that section was to be liberally construed and was remedial in character.

Seasongood v. Comm'r, (CCA-6) 227 F. 2d 907.

The facts in the Riker and Grassmee cases, indicate a strong factual situation justifying the public policy and remedial character of the section. One making a gift to one's own church for religious purposes should have the same liberal rules applied as indicated by the above decisions which are but a few of the many holdings in the various reported decisions.

B.

It should be pointed out that a gift to a non-exempt organization has been held deductible where the gift is "for the use of" the purposes under Section 23 (o).

In *John Danz*, 18 T.C. 454 (1952), Section 23 (o) uses the language "to or for the use of". It shows that gifts for religious, charitable, scientific, literary or education purposes are intended by Congress to be deductible from gross income in computing taxable income. In the case at bar all donations (R. p. 109) were made and accompanied by a written instrument (Exhibit 8) that stated the gift was to be used solely for religious purposes (finding, R. p. 83) of the Church. The first paragraph of Exhibit 8, Church Form 399 reads:

“Transmitted herewith is an outright gift of:
(\$.....)

Amount of item

to the Elected Delegates Committee of The
 Ecclesiastical Society of Christ’s Church of The
 Golden Rule, to be used by them exclusively for
 religious purposes of the Church.

.....

.....
 Sign in Ink—Name in Full”

Such language, per se, in a written document would and does create a gift in trust for the religious purposes. If made to any person, clearly not an exempt organization as for example a trust company, private person or a group of individuals it would be a gift in trust, enforceable in a competent Court, and recognized as a valid and deductible gift for religious purposes within Section 23 (o). The facts are doubly strong when the gift goes to a committee of the Church, chartered under its Church Constitution and Canon laws (finding, R. p. 82) that provides the money and property be held upon a trust for religious purposes (Canon Law No. 20, R. p. 52) and the spiritual body (Ch. Const. VI (7) R. p. 27-8); Canon Law No. 3, page 33; No. 8, pages 37-8) and that contains the numerous safeguards and remedies (R. p. 20-67) heretofore detailed in this brief.

This question of deduction of gifts accompanied by this written statement, to this Church with these Canon laws, is of vital importance to numerous members of this Church whose cases are pending in the

Agent's office. This is a test case to determine the points of law. (See affidavit to amend petition, R. p. 74-6.)

II.

THE CHURCH COMMITTEE IS AN EXEMPT ORGANIZATION UNDER SECTION 101(6) AND A RELIGIOUS ORGANIZATION WITHIN SECTION 23(o).

A *Section 23 (o)* organization or fund or trust is one organized and operated exclusively for religious purposes, no part of the net income of which inures to the benefit of any individual and no substantial part of the activities of which is carrying on propaganda or otherwise attempting to influence legislation.

Section 101 (6) provides:

“The following organizations shall be exempt from taxation under this chapter—(6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;”

The Elected Delegates Committee received all its donations and Student Minister Training Application funds accompanied by a written Church Form No. 399 that specifically stated the property was solely for the religious purposes of the Church (finding,

R. p. 83, Exhibit 8, R. p. 109). It administered a trust or fund solely and exclusively for the religious purposes.

In addition to this Church Constitution and Canon laws specifically spell out and provide for the use of the money and property exclusively for the religious purposes (Church Const. VI, subd. 7, R. p. 27-8, Canon Laws No. 20, R. p. 52; No. 3, R. p. 33; No. 8, R. p. 37-8). Canon Law No. 20 (R. p. 52), prohibits any person from having any interest in any of the Committee's property. Canon Law No. 25 (R. p. 56) makes it an offense for any person in the Church to direct or misuse property of the Committee from its religious uses, punishable by the Church judiciary, a separate branch of the Church organization. Canon Law No. 19 (R. p. 51-2) provides for safeguards so that the temporal agency cannot draw money under excuse of salaries, and an ecclesiastical officer (a separate organization) must find the written contract of remuneration is within the religious purposes and necessary to carry these purposes out. Canon Law No. 10 (R. p. 39-4) specifically prohibits any income of the Committee to inure to the benefit of any person, shareholder or certificate holder, but all income of any temporal agency, group, etc. within the Church must be always used for the religious purposes of the Church.

Canon Law No. 11 (R. p. 40) specifically prohibits any property of the Committee or other temporal agency from being used for propaganda or influencing legislation and Canon Law 21 (R. p. 52-3) prohibits

any person in the Church from using his office or connection or membership for political purposes, to promulgate or spread propaganda or to influence legislation. The safeguards to enforce and implement these organizational laws are many. They can be initiated by the spiritual head (Senior Elder) or by the spiritual legislative body (Board of Elders) or by the Church judiciary. Any member may initiate the action in the Church judiciary. The membership can by a demand of 25% of the members convene a convention of elected representatives with full power to declare any office vacant and fill it by majority vote and can amend any doctrine or ecclesiastic ruling (Const. IX, R. p. 29-30).

Although the law on exempt organizations was changed in 1951, the statute Section 101 (6) and Section 23 (o) in the years 1947 through 1949 involved in this case, has been the subject of many judicial decisions.

A.

One test sometimes applied to organizations to determine whether or not they are exempt within Section 101 are the instruments that create them, that is their charter and organizational laws. Any act outside of those would be *ultra vires* and the purposes and powers prescribe the authority and sphere of action.

- Harrison v. Barker Annuity Fund*, (CCA-7) 90 F. 2d 286;
U.S. v. Proprietors of Social Law Library, (CCA-1) 102 F. 2d 481.

B.

Most of the circuits have applied the "ultimate destination" rule in determining whether a commercial enterprise is exempt under Section 101 (6). Stated another way, whether its purpose is to devote its profits to religious, charitable or educational purposes is the test of whether the organization is exempt or not.

Roche's Beach Inc. v. Comm'r, (CCA-2) 96 F. 2d 776;

Koon Kreek Klub v. Thomas, (CCA-5) 108 F. 2d 616;

Debs Memorial Radio Fund v. Comm'r, (CCA-2) 148 F. 2d 948;

U. S. v. Pickwick Elec. Membership Corp., (CCA-6) 158 F. 2d 272;

Bohemian Gymnastic Assoc. v. Higgins, (CCA-2) 147 F. 2d 774;

Willingham v. Home Oil Mill, (CCA-5) 181 F. 2d 9;

Scofield v. Rio Farms, Inc., (CCA-5) 205 F. 2d 68;

Crooks v. Kansas City Hay Dealers Assoc., (CCA-8) 37 F. 2d 83;

Mueller Co. v. Comm'r, (CCA-3) 190 F. 2d 120.

There are cases to the contrary involving hard facts as where only a small part of the earnings actually go to the exempt purposes as *U.S. v. Community Services*, (CCA-4) 189 F. 2d 421 where a business corporation was formed to operate a canteen for a specific mill, and although the articles of incorpora-

tion provide for all the profits to be used for religious, charitable and scientific purposes, the record shows that only a small part of the receipts were earnings and only a portion of the earnings were used for the exempt purposes and the balance used by the corporation or set aside as a reserve. This *Community Service* case was disapproved by the Court of Claims in *Sico Co. v. U.S.*, 102 Fed. Supp. 197 on the authority of *Mueller v. Comm'r*, (CCA-3) 190 F. 2d 120, and the *Mueller* case is directly contrary.

In *Scofield v. Rio Farms, Inc.*, 205 F. 2d 68, the 5th Circuit in passing on a capital stock tax imposed on a corporation created to meet social problems and assist from within a certain tract to improve and benefit their situation, which farmers were not the recipients of charity, held the liberal construction is to be accepted in favor of the exemption, and held the use of the profits and not the source determines the exemption. The 5th Circuit held that the weight of the authority is with this rule and cited *Koon Kreek Klub v. Thomas*, 108 F. 2d 616 and *Willingham v. Home Oil Mill*, 181 F. 2d 9 that liberal construction be applied in favor of the exemption.

It appears from language in *Retail Credit Association of Alameda Co. v. Comm'r*, (CCA-9) 90 F. 2d 47, citing *Crooks v. Kansas City Hay Dealers Association*, (CCA-8) 37 F. 2d 83 and *Trinidad v. Sagrada Orden*, 263 U.S. 578, 44 S.Ct. 204, 68 L. Ed. 458 and from the language in *Smyth v. California State Automobile Association*, (CCA-9) 175 F. 2d 752, that it is the purpose to which the income is devoted which

determines whether or not the exemption exists, citing *Koon Kreek Klub v. Thomas*, (CCA-5) 108 F. 2d 616 and *Trinidad v. Sagrada Orden*, 263 U.S. 578 that this circuit might favorably consider this rule as the law of this circuit.

C.

In *Squires v. Student Book Corp.*, (CCA-9) 191 F. 2d 1018 this circuit stated it was an open question as to whether the "ultimate destination" rule were to be followed and indicated that in the *Smyth* case (175 F. 2d 752), the ultimate destination rule was cited with approval, that the law as to exempt organizations was changed in 1950, effective in 1951, and that a book store run by a commercial corporation whose stock was owned by Washington State College regents under a trust for the benefit of the Associated Students was exempt. The Court held "The business enterprise in which the taxpayer is engaged bears a close and intimate relationship to the College itself" as the test of the exemption. In this case the corporation sold books to the faculty and students and ran a kitchen and restaurant for the students. The income was used for the construction of the Student Union and the acts of the Associated Students was subject to the approval of the College President.

Some decisions apply the test that there must be a primary purpose for which the organization is founded within the exempt purposes such as religious, charitable or educational. These decisions recognize

that money is essential to the conducting of any such purpose. If the organization to obtain the means of carrying on its purpose engages in some commercial enterprise, though not necessarily connected therewith or related thereto, the organization is still exempt under Section 101.

The 9th Circuit in *Retail Credit Association of Alameda County v. Comm'r.*, 90 F. 2d 47, adopted this rule of primary purpose and held that where an ordinary business for profit is purely incidental to the main or principal purpose as in *Crooks v. Kansas City Hay Dealers' Association*, (CCA-8) 37 F. 2d 83, and *Trinidad v. Sagrada Orden*, 263 U. S. 578, the organization is exempt. The Court held that in determining whether a purpose to engage in a regular business of a kind ordinarily conducted for profit is merely incidental or subordinate, each case must stand on its own facts. In that case the Court held that although there was no exemption and the organization acting as a collection agency and credit reporting bureau for fees and charges and was conducting a business not incidental to a main or principal purpose, there was nothing in the statute or regulations prohibiting any exempt organization from engaging in any form of business. The purpose was the test.

Crooks v. Kansas City Hay Dealers' Association, (CCA-8), 37 F. 2d 83, held that charging of fees to inspect and weigh hay by the voluntary association of the market dealers was incidental to the main purpose to give integrity to the hay market. The Court

held that the fact that an organization receives some income to carry on its work is no proof it was organized for the sake of profit. The test was the main purpose and the ultimate destination of the profits and property acquired.

Koon Kreek Klub v. Thomas, (CCA-5) 108 F. 2d 616, in holding a fishing and hunting club owning 6,777 acres and who let land for livestock (its articles authorized it to raise livestock for profit) and used the income for organizational purposes was held an exempt organization. The decision pointed out that the financial gain was incidental to and directed toward the accomplishment of its purposes; that the statute says nothing of the source of the income, but ultimate destination is the test. The decision recognizes the necessity of an organization having money to carry on its exempt purposes and observes that deriving funds for this purpose is no departure.

Willingham v. Home Oil Mill, (CCA-5), 181 F. 2d 9, involved a business corporation whose stock was bequeathed to a trust and whose articles were amended to require its purpose to be religious, charitable and educational and no net income of which could inure to the benefit of any individual. The decision quotes Marshall in the Dartmouth College Case that if a civil institution were employed in the administration of government it would be a public corporation and draws the analogy to where a private corporation be employed in administering for religious, charitable and educational purposes. The Court

held the sole purpose was to devote the net income to the exempt purposes and it was an exempt organization.

Bohemian Gymnastic Association v. Higgins, (CCA-2) 147 F. 2d 774 involved the conduct of a bowling alley, kitchen, bar and restaurant as an incident to the main purpose of a gymnasium for educational purposes. The Court in holding the organization exempt, followed the ultimate destination rule and held these fund raising businesses incidental to the main educational purpose. The Court held that the exemption was not to be denied a religious or charitable organization which raises its money through some business not its principal object. Dues are not a test, either.

U. S. v. Pickwick Elec. Membership Corp. (CCA-6) 158 F. 2d 272 involved a corporation organized to distribute T.V.A. power. The Court held it was organized and operated for purposes under two Subdivisions of Section 101, and these sections are cumulative and not mutually exclusive. The Court held its principal purposes not a commercial one, and although it served both members and non-members making a charge to them which resulted in a profit, it only provided a prudent margin of safety and over a period of time operated on a non-profit basis. Here again the test was ultimate destination coupled with its principal purposes being exempt purposes. The Court recognized the need for money to effect the exempt purpose, even to retaining a safe margin to be able to carry these purposes out over a long period of time.

Debs Memorial Radio Fund v. Comm'r, (CCA-2), 148 F.2d 948, involved a radio station that made charges to the public for radio time and used its money for its educational purposes for which it was exempt. The Court followed the ultimate destination rule. The facts indicate a business related to its principal purpose, the need for funds to effect that purpose and its principal purpose was educational and the revenue was only incidental.

Comm'r v. Orton, (CCA-6) 173 Fed. 2d 483 held a foundation an exempt organization. This foundation was created by will of Orton, an engineer and on Ohio State University faculty, to manufacture and sell for a profit cones for testing heat in ceramic manufacture and use the net profit of 20% of sale prices to do further research in the ceramic industry. The Court held that this was a foundation to promote science or art and the manufacturing business was not run in a vacuum but was related to the objective of good ceramic manufacture and the profit for research; and distinguished ordinary business enterprises that were run solely for personal financial gain.

D.

The leading case on religious exempt organizations is that of *Trinidad v. Sagrada Orden*, 263 U.S. 578, 44 S. Ct. 204, 68 L. Ed. 458 in which the corporation sole of the established Church in the Philippines held large properties from which it collected rents, owned stock in private corporations, loaned money at interest

and received small sums from alms and sale of supplies as chocolate, wine, etc. connected with its religious work. All of the income was devoted to the religious work of that Church. Suit was brought for return of income tax, claiming the corporation sole was exempt as a religious organization. The Supreme Court held (263 U.S. at 581):

“Whether the contention is well taken turns primarily on the meaning of the excepting clause, before quoted from the taxing act. Two matters apparent on the face of the clause go far toward settling its meaning. First, it recognizes that a corporation may be organized and operated exclusively for religious, charitable, scientific or educational purposes, and yet have a net income. Next, it says nothing about the source of the income, but makes the destination the ultimate test of exemption.

“Evidently the exemption is made in recognition of the benefit which the public derives from corporate activities of the class named, and is intended to aid them when not conducted for private gain. Such activities cannot be carried on without money; and it is common knowledge that they are largely carried on with income received from properties, dedicated to their pursuit. This is particularly true of many charitable, scientific and educational corporations, and is measurably true of some religious corporations. Making such properties productive to the end that the income may be thus used does not alter or enlarge the purposes for which the corporation was created and conducted. This is recognized in *University v. People*, 99 U.S. 309. . . .

“The plaintiff, being a corporation sole, has no stockholders. It is legal representative of an ancient religious order, the members of which have, among other vows that of poverty. According to the Philippine law under which it was created, all of its properties are held for religious, charitable and educational purposes; and according to the facts stipulated it devotes and applies to those purposes all of the income-rents, dividends and interest from such properties. In using the properties to produce income, it therefore is adhering to and advancing those purposes, and not stepping aside from them or engaging in a business pursuit.”

In *Retail Credit Association v. Comm’r*, (CCA-9), 90 F. 2d 47, it was pointed out that the trade in chocolate, wine, etc. for profit in the *Trinidad* case (supra) was purely incidental to the religious purposes. It is clearly a “related” business under the present law on exempt organizations.

The present law on exempt organizations, although not applicable to these two cases because it became effective in 1951 now turns on “related business income” thus following the rule of *Trinidad v. Sagrada Orden*, 263 U.S. 578.

26 U.S.C.A. 511 (1954 Internal Revenue Code) taxes *unrelated business income* which is any trade or business, the conduct of which is not substantially related (aside from need) to exercise or performance of its charitable, or educational purpose. Where substantially all the work is carried on by the organiza-

tion without compensation, as in the Student Minister Training Program of the Church, it is not taxable. The tax does not apply to churches. 26 U.S.C.A. 511.

The Tax Court in the instant cases found (R. p. 82-83):

“In operation, activities of the Church members are of two types. Some members devote all of their time to working on Church projects and studying to be ministers of the Church’s teachings. These are called student ministers, and they live in the apostolic societies called ‘Student Minister Training Projects’. One purpose of these projects, most of which are engaged in commercial activities, is to spread the teachings of the Church by having the public witness the application of those teachings in everyday life. Some projects were not engaged in commercial activities but simply operated residential facilities for the Church members. Members living in both types of projects contributed their earnings to the Church. Other Church members lived at home and participated in Church activities. The Church operated a theological seminary.”

The decision of the Tax Court also states:

“The Church has no church buildings. Its principal reliance is on having its members live in a manner exemplifying Christ’s teachings, particularly by living in a selfless manner. Its student minister training projects, while engaging in commercial activities, were designed to permit the public to witness the application of Christ’s teach-

ings to everyday life. Thus the very means chosen by the Church to attain its spiritual purpose involve engaging in commercial activities through its principal temporal agency, the Committee, . . .”

The Church Committee filed a Form 990 return for September 1947 to 1948 (Exhibit 2) and for September 1948 to 1949 (Exhibit 4, finding page 84) as an exempt organization under Section 101, Subdivision 6, showing the facts required.

The Canon Law No. 12 provided that those who devoted their time and efforts to the Lord’s work should have it made possible by meeting their needs and those of their families and dependents so they could devote their time, by the apostolic form of living. The Spiritual body officials determined how much was the budget therefor. The Committee then met those needs as a religious purpose. Only bare necessities were provided (R. p. 134, 118-119) and covered all living expenses of food, clothing, doctor bills, medication, etc. (R. p. 119). The group at San Bernardino of a dozen or more (R. p. 116) lived on a ranch and consequently produced much of their food, and therefore received less than average (R. p. 148). The total Student Minister Maintenance for fiscal year 1948 of 575 individuals was \$202,890.47. (R. p. 122) which is \$351 per person per year or \$30 per person per month. This shows a frugal existence. The testimony shows the members were dedicated to a religious crusade and gave freely and liberally of their income to it. They certainly never carried on or joined this

crusade for personal gain. The bare existence was necessary but wholly incidental to the religious crusade.

The evidence and findings shows the so-called commercial enterprises but a means of application of Christianity to everyday life. It was a laboratory to apply the religious studies. It was the means of spreading their teachings of Christ as they believed it. It was their ministry.

Projects were selected and maintained upon the basis of more widely spreading the Church teachings by having the public come in contact with the student ministers in training, and to make it possible for the student ministers to express and live in their daily activities the teachings of the Church (R. p. 115-116). The business operation was wholly incidental (R. p. 119). Some ran at a loss and the consideration of maintaining and continuing them was solely whether or not it was serving the purposes of promulgating the Church's teaching and its ministry (R. p. 120). The only salaries paid were those to personnel outside of the Church where a particular skill or training were needed and none were in the Church (R. p. 123). No one in the religious society was paid any salary (R. p. 123). Any excess above actual operation went to publications (R. p. 124), and to expanding the religious work through more facilities to permit others to learn this concept of religion (R. p. 126-127). It did not go to any better living for those in the ministry or their families (R. p. 126).

The expense of the so-called businesses which were an incident of and means of practicing, spreading the teachings of the Church were actually operated at a loss for the costs of supplies, power, etc. of the Student Minister Training plus the costs of the support of the labor in them, (Student Minister Maintenance), fell far short of the income (Student Minister Application) and the difference was made up by substantial gifts \$137,491 (R. p. 121) and exhaustion of resources owned and used by the Church Committee. See Exhibits 2 and 3 for 1947-1948 and 5 and 6 for 1948-1949. They were not profitable in any sense of the term measured by commercial or accounting means. Measured by spiritual results and spreading of Christianity they were highly valuable.

That a Church would believe enough in Christianity to show the public by actual example to those who came in contact with it, does not make it any the less a religious activity or its purpose any the less a religious purpose. Its sole purpose is religion. That it uses a less conventional or a unique mean does not make it any the less an exempt organization.

Any so-called commercial activity was purely incidental to and bore an incidental relationship to its religious purposes and was solely to carry out those religious purposes. It was related to the performance of its religious purposes.

III.

AN APOSTOLIC OR RELIGIOUS SOCIETY IS AN EXEMPT ORGANIZATION UNDER SECTION 101, SUBDIVISION 18.

The statutes in effect in 1947 to 1949 by specific provision exempt Religious or Apostolic Societies from income tax. Section 26 *U.S.C.A. 101 (18)* provides:

“101. The following organizations shall be exempt from taxation under this chapter—

‘(18) Religious or apostolic associations or corporations, if such associations or corporations have a common treasury or community treasury, even if such associations or corporations engage in business for the common benefit of the members, but only if the members thereof include (at the time of filing their returns) in their gross income their entire pro-rata shares, whether distributed or not, of the net income of the association or corporation for such year. Any amount so included in the gross income of a member shall be treated as a dividend received.’ ”

In the cases at bar of Grassmee and Riker, the Religious Association, Elected Delegates Committee of the Ecclesiastical Society of Christ’s Church of the Golden Rule, filed its returns as required by the Commissioner’s Regulations for Subdivision 18 by filing the form 1065 return (partnership form) reporting as such all gross funds from all sources for both year 1947-1948 and 1948-1949 according to its fiscal year (Exhibits 3 and 5). Attached to each return as filed was the list of names of all members, 575 for 1947-1948 and 602 for 1948-1949 (R. p. 106).

The 1947-1948 returns of the Committee reported:

Application of Student Minister

Training	\$347,489.99
Donations	137,491.45

Total Gross Income	\$484,981.44
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Operating Expense of Student Minister

Activities:

Materials and Supplies	\$ 54,828.74
Operating Expense (incl. repairs, maintenance, etc.)	55,911.20
Wages to non-members	21,216.27
Transportation (incl. oil and gas)	48,195.29
Rentals paid for projects	71,996.23
Insurance (plant, liab., etc.)	5,153.01
License fees	2,798.23
Taxes (sales, property, etc.)	8,924.30
Overhead (incl. advertising, legal, management, etc.)	9,900.37
Religious Publications and Schools	9,247.09

Total	\$288,170.73
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Student Minister Maintenance, (clothing, dental, eye glasses, food, household, medical, personal incidentals, housing utilities, recreation, etc.)

\$202,347.04

Total	\$490,517.77
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Of the gross receipts of \$484,981.44, there was an actual cash deficit of \$5,536.33 and the 1065 return did not deduct any expenses other than those connected with the so-called commercial activities used to illus-

trate the Church teachings and the ministry of the Church and training of the student ministers. It showed actual \$217,001.54 net income (omitting the Student Minister Maintenance, the Religious Publications and Schools, and payments to principal on notes and mortgages).

The members filed their individual returns for the year, including in each of their gross income the pro-rata share of $1/575$ of the \$217,001.54 of the Church Committee.

Riker. Attached to her return for 1948 (Exhibit 6, pages 107-108) was a mimeographed sheet which showed the fact of receipt of \$8,959.11 and stated:

“However, under the rules of the apostolic society (of which taxpayer is associated) that all in the society share their income \$8,959.11 was contributed to and became a part of the income of the society, and is reported as a part thereof. Taxpayer would therefore be taxed twice on the same income by reporting as wages and also as dividend. For this reason, this latter sum is reported only as part of the dividend or taxpayer’s pro-rata share of the net income of said apostolic religious society (See Item No. 3 Dividend).

“Item 3. Dividend. $1/575$ interest in \$217,001.54 net income of ‘The Elected Delegates Committee of the Ecclesiastical Society of Christ’s Church of The Golden Rule, an Apostolic Religious Association, for its accounting period of October 1, 1947 to October 1, 1948. This was not received as a dividend, but is reported under Section 101(18) per person in Association \$377.39.

“Number of persons in taxpayer’s family who were in association and obtained support for Society during period:

2 times \$377.39——\$754.78.”

Mrs. Riker had a six year old daughter and thus returned as a family unit on the face of her return the \$754.78 as the pro-rata share or dividend as income.

Grassmee. Attached to her return for 1948 was the same mimeographed sheet and showed she was employed and had wages, all of which she gave to the Church. She lived with her 84 year old mother in the Church group and so she returned dividends or pro-rata shares for two persons of \$754.78 (Exhibit 11).

Mrs. Grassmee for 1949 filed her return attaching a similar sheet showing her wages of \$1,312.50 in her employment by Paul W. Sampsell and that all of this was contributed to the Church and included in the income of the Apostolic Society income tax return. She showed her dividend for herself and her 84 year old mother (Exhibit 12).

“1/602nd interest in \$190,337.32 net income of the Elected Delegates Committee of the Ecclesiastical Society of Christ’s Church of The Golden Rule, an Apostolic Religious Association, for its accounting period of October 1, 1948 to October 1, 1949. This was not received as a dividend, but is reported under Section 101(18)—per person in the Association, \$316.17.

“Number of persons in taxpayer’s family who were in the Association and obtained support from the Society during period:

2 times \$316.17——\$632.34.”

All of the others in the Apostolic Religious Society filed similar returns.

The Committee as the common community treasury filed the tax return as an Apostolic or Religious Society following both the spirit and letter of the law (26 U.S. CA 101(18)) and the regulations. So did the members who reported a pro-rata share.

By express terms of the statute, 26 U.S. CA 101 Subdivision 18, the organization is thus an exempt organization even though it could engage in business as a primary purpose (which it did not).

A.

An organization can be exempt under two subdivisions of Section 101, for they are cumulative and not mutually exclusive.

U. S. v. Pickwick Elec. Membership Corp.,
(CCA-6) 158 F. 2d 272.

B.

The provisions of Subdivision 18, Section 101 concerning Apostolic or Religious Associations have not been the subject of judicial reported decisions. This case is one of first impression.

The Elected Delegates Committee in 1947-1948 fiscal year received a total gross of \$484,981.44 which consisted of donations of \$137,491.45 and Application of Student Minister Training of \$347,489.99. The cost of materials, supplies, interest, operating expenses, wages to outside help, etc. to conduct the ministry from which there was related revenue of \$347,489.99

was \$273,516.23. If there were ordinary business accounting, a substantial part of this \$347,489.99 was the product of personal services by the student ministers and it cost the Church \$202,347.04 for Student Minister Maintenance for this labor or personal services. Thus by business accounting there was an actual operating loss of about \$120,000 if this be viewed as a business venture, which it was not. It was the laboratory of the theological studies and the ministry of the Church. It was the practice of religion and its promulgation and spreading to all who came in contract with it. The donations of \$137,491.45 made by individuals to the Church for its religious purposes made the ministry possible.

The Elected Delegates Committee in 1948-1949 fiscal year received a total gross of \$409,590.05 of which \$352,528.70 was from Application of Student Minister Training. The actual expenses of this so-called commercial activity but actually student ministry laboratory work and the ministry of the gospel was \$219,252.73 for materials to operate, goods to sell, interest, operating expenses, etc. A substantial part of this related gross income of \$352,528.70 was the personal services and labors of the student ministers, which if this were an actual commercial venture would be \$187,570.01, the actual cost of Student Minister Maintenance to the Committee. Again, if this were viewed as a business venture, there was a very large operating net loss. Being a religious activity and any revenue being wholly related to these religious activities, the differential was made up by donations of individuals to the Church for religious purposes.

Now let us view this from the standpoint of the individual members. Mrs. Grassmee in 1948 worked in private employment and received about \$2,100 wages. She received for herself from the Church $1/575$ th part of the \$202,347.04 spent on student minister maintenance or about \$351. If this were a business venture and she made a transaction where she transferred \$1,407 of her wages for \$351 for herself and \$351 for her mother, she would stand a \$705 loss (short term) as she got the support daily and paid currently. Under good accounting practice, she would have a salary to report, and from that deduct her \$1,056 loss of her business transaction (\$1,407 less \$351) and wind up with \$1,044 taxable income, if it be viewed as a commercial transaction and as the Commissioner ruled she did not support her mother. If she supported her mother, she had a net taxable income in 1948 of \$1395 before two personal exemptions.

Mrs. Grassmee in 1949 earned \$1,312 from wages at her private employment. If she made a commercial transaction in which she paid that to the Committee and received a $1/602$ nd part of the \$187,570.01 spent by the Church for Student Minister Maintenance, she would receive \$312 in support, and a short term loss of \$1,000 as she paid her salary as received and currently received her support daily. If she alone got support, her income tax return would show the \$1,312 wages and the short term loss of \$1,000 and her net taxable income would be \$312 before personal exemptions. If her 84 year old mother were dependent on her, she got twice \$312 or \$624 which would be her net taxable income subject to two personal exemptions.

The same results would be reached as to Riker who had a six year old daughter. Her net taxable income for 1948 would be \$702 before two personal exemptions. For 1949 it would be \$624 before exemptions.

But this is not a business venture. It is not an exchange of income for support. The whole relationship is that of parishioner and Church.

The Church Committee filed its return as an exempt organization for 1947-1948 and 1948-1949 fiscal years on Form 990, showing all monies from all sources and how it was spent.

To be doubly safe, the same Church Committee filed its return as an Apostolic Religious Association.

C.

Should the Committee holding the common community treasury report only the Student Minister Training Application, and show only its loss, as gifts are not taxable income, OR should it report all money from all sources including gifts as it has reported them?

(1) If the Committee reported only related income of the Student Minister Training Application, and deducted by good accounting practices its costs therefor, it would deduct not only costs of operations for supplies and power, and rent, but also costs of its labor which is Student Minister Maintenance. This would be a substantial net loss for both 1948 and 1949. The pro-rata share would be a substantial loss instead of income.

(2) If the Committee reported donations along with its related income, and without deducting Student Minister Maintenance there would be a pro-rata net income. However, as the income given to the Church Committee would be reported by it and each member would pay a proportional share of these donations, is the donor of gifts taxable when earned, and again to each member on the same earnings, including the donor?

(3) Would the donor, if the donation is taxable as earned, deduct the religious purpose donation under Section 23(o)?

It can be seen that application of contentions by the Commissioner lead to absurd results:

(a) Mrs. Riker is taxed as her income all funds earned by her group as related income whether the product of the group's services or product of the Church's property.

(b) Mrs. Riker transmitted all of the related income of the group and the Church property with written Church forms that the money must be used for religious purposes. Though taxed as personal income she cannot even deduct the 15% of these funds under Section 23(o) as a religious gift.

(c) Mrs. Riker donated the product of her effort and labor under the partnerships together with the product of the capital and equipment of the Church, partly exhausted in these efforts and earnings. The purpose of these operations is to permit the Church to sell its equipment and salvage its capital investment.

Even this income for religious purposes donated to the Church the Commissioner contends is not subject to 15% deduction of Section 23(o).

(d) Mrs. Riker reported her pro-rata share of the income of the Apostolic Committee, which Apostolic Society returns included both the Group related earnings of \$8,959.11 and her donations from the partnership efforts on which the Commissioner sought to impose a tax. She reported two pro-rata shares of \$377.39; one for herself and one for her daughter, a total of \$754.78. The Commissioner in the deficiency computation, part of the record as an exhibit to the petition before the Tax Court, sought a tax on not only the group's related income to her, and the donation of the partnership efforts but also to tax Mrs. Riker for these *plus* her pro-rata shares of herself and daughter of the Apostolic Society's income which included both these sums of Group related income and her own donations. No 15% deduction was allowed under Section 23(o).

(e) Mrs. Grassmee is sought to be taxed by the Commissioner in her deficiency letter, an exhibit to her petition to the Tax Court, not only for her personal earnings all of which she gave to her Church with a writing stating it was for religious purposes, but also for her pro-rata share of the Apostolic Group which included this very gift she made. She and all of the individuals in the Apostolic Society are taxed on these same earnings as they make up a part of the donations, a substantial part of the Association's income.

(f) Mrs. Grassmee is not even permitted by the Commissioner's contention a Section 23(o) deduction for gifts to her Church for religious purposes, but taxed for earning the money and then on her pro-rata share of all gifts including her own, made to the Church.

(g) Not only is the assessment made seeking to tax Mrs. Grassmee for her earnings given to the Church, but also for *two* distributive shares, one for herself and one for her mother, yet the Commissioner claims she is taxable without taking the personal exemption of the mother.

D.

We think the true rule is:—

Reporting: (1) The Elected Delegates Committee should report *all* money and income from all sources, both donations and related income.

(2) All members, a part of the religious apostolic society should report all monies and income and show how much was given to the Church. Each must report their pro-rata share as a dividend under Subdivision 18 of Section 101 of the net income, including gifts reported by the Church Committee.

(3) All in the apostolic religious society should report by family groups. Babies in arms and old persons 84 years old need not make individual returns under penalty of losing their individual exemption. The extra work of the taxing office and the individuals

does not require this mass of individual detail involved in so many returns. The custom of returns by family units, with each pro-rata share of each person in the group should be sufficient. It works with those outside the religious apostolic society. It should work within the group. In view of the common sense and customs and rules as to personal income tax returns and the work any other practice would involve, the reporting by family group of both income and exemptions for children and old folks (84-5 years old) would seem the proper course.

Taxing: (1) The Church Committee is exempt under Subdivision 6 and Subdivision 18 of Section 101. As such it is not taxable.

(2) The individual who earns any sum and keeps it and does not donate it to her Church is taxable as income. This involves no problem.

(3) Those who give anything to their church should be entitled to the Subdivision 23 (o) deduction on such gifts. Such earnings would be taxable, after that deduction, to the individual earning it.

(4) If the Court determines the pro-rata share of those in the Apostolic Religious Association should be computed on *all* sources of revenue, both related income and donations, then the various individuals would report their wages, deducting actual gifts therefrom to their Church and *all* in the apostolic religious corporation would report as part of their income their pro-rata share of donations received by the Church. The donor would then deduct gifts actu-

ally made from earnings and include his pro-rata shares of the members. Otherwise, those earnings would be taxed twice.

(5) If the Court determines the pro-rata share of those in the apostolic religious corporation should not include the donations, the pro-rata share would be reported by the family group and taxed as income. The donor would be taxed on income including that given to the Church, less the 15% Subdivision 23 (o) deduction.

(6) In no event would an official of the Church be taxed as an individual for money earned by the Group's efforts in their ministry or for the return on capital invested by the Church in the facility or for exhaustion of Church property (depreciation) used to earn that related income of the ministry of the Church. Arithmetical mistakes or failure to include costs of supplies consumed in earning that related income, should in no event be the basis of any personal tax liability of the spiritual instructor of the local group, such as Mrs. Riker.

IV.

A CHURCH UNDER CALIFORNIA LAW HOLDS ITS PROPERTY IN TRUST FOR THE SPIRITUAL BODY WHICH IS ALL IMPORTANT AND A CHURCH CORPORATION OR TRUSTEES ARE WHOLLY SUBSERVIENT.

The Tax Court opinion assumes that since the temporal agency was holding property under trust for the religious uses of the spiritual body and was sub-

servient thereto, the temporal agency was taxable and not an exempt organization. This was because of the particular religious beliefs of the spiritual body that it taught Christianity by application to everyday activities by having the public witness these applications of these teachings.

The leading case of *Watson v. Jones*, 80 U.S. (13 Wall.) 679, 20 L. Ed. 666, holds a religious society's property is held in trust for the doctrines of the Church.

The leading case in California as to religious societies and their property is *Wheelock v. First Presbyterian Church*, 119 Cal. 477, 51 P. 841: This decision involved the dissolution of a church corporation and the division of the church to two separate organizations by the principal organization of the Church. The Court held that the spiritual or ecclesiastical body of the Church was all important, and that the Church corporation was a mere convenience to assist in the conduct of the temporal part of the Church, that notwithstanding the incorporation, the ecclesiastical body is still all important and the corporation is a subservient factor. The Supreme Court, in that decision went on to hold that a religious corporation is something peculiar unto itself, and that its function is to stand in the capacity of an agent holding title to property, with power to manage and control the property in accordance with the spiritual ends of the Church. The Supreme Court, in that case, held that the incorporation did not change the ecclesiastical status of the congregation, but only afforded

a more advantageous civil status; that the directors or trustees of the Church corporation have no authority over church affairs which rests with the ecclesiastical body. The Court held that property standing in the name of a Church corporation is held in trust for use of the Church proper, and the trustees hold the property for the use and enjoyment of the Church, and every member in it is a beneficiary of that trust. The Court held that the Church corporation held under a trust as completely as if the trust were declared by deed, and such a trust is not distinguishable from other trusts over which the court of equity have general supervisory powers.

The California Supreme Court in *Baker v. Ducker*, 79 Cal. 365, 21 Pac. 763, held that the property acquired by a religious society was held under a trust by the Church corporation, and a parsonage obtained by contributions could not be diverted to other uses by a majority of the membership. The case of *Bomar v. Mount Olive Missionary Baptist Church*, 92 Cal. App. 618, 286 Pac. 665, followed the doctrine of *Wheellock v. First Presbyterian Church*, 119 Cal. 477, and held that the ecclesiastical body was all important, and the corporation a subservient factor in the life and purposes of the church; and that the corporation was a mere agent or instrument for holding title to property and managing the temporal affairs.

Many churches, as does this Church of Christ's Church of The Golden Rule, divide the powers and authority. Spiritual matters are often conducted by an organization or Church Session. Property and

matters secular are often handled by trustees, a non-profit corporation with directors or trustees or a corporation sole. The spiritual body or Church government is all important. It deals with doctrines, teachings, Church practices and services. The property or secular matters are conducted by a temporal agency or trustees, incorporated or unincorporated, who deal with the money and property, pay ministers, sextons, support religious training. They hold as trustees under a religious trust for the spiritual organization.

The cases hold that as to religious matters, the determination of the highest authority in the Church are conclusive in the Courts.

Gonzales v. Roman Catholic Church, 280 U.S. 1, 50 S.Ct. 5, 74 L. Ed. 131;

Permanent Committee v. Pac. Synod of Presbyterian Churches, 157 Cal. 105, 106 P. 395.

Under our concepts of freedom of religion we leave matters wholly ecclesiastical to the Church such as who is qualified to be a chaplain of a parish, who is qualified by religious beliefs to admission into Church membership, matters of discipline, faith and ecclesiastical rule. Courts under our Constitution cannot sit as ecclesiastical tribunals to try questions of religious belief or faith. When such questions arise, the Courts deal only with property. Matters ecclesiastical are determined by ecclesiastical officials or Church governments or authorities. The Court must accept their determinations and conclusions and then apply them to the property rights in dispute. This is true though the ecclesiastical matters which the Court must fol-

low the particular Church government's determination effects the property rights at issue.

In *Permanent Com. of Missions v. Pacific S. Presbyterian Church*, 157 Cal. 105 it was held:

“Lest we be understood to hold that the civil courts can disregard and overrule the decisions of the church authorities, acting regularly, in ecclesiastical matters, we expressly disavow that doctrine. We approve the principle laid down by the Supreme Court of the United States in *Watson v. Jones*, 80 U.S. 726, and by the Supreme Court of this state in *Horsman v. Allen*, 129 Cal. 136, relating to this subject. ‘Whenever the questions of discipline, or of faith, or ecclesiastical rule, custom, or law have been decided by the highest of the church judicatories to which the matter has been carried, the legal tribunals must accept such decisions as final, and as binding on them, in their application to the case before them.’ *Watson v. Jones*, supra, 80 U.S. 727, 20 L. Ed. 666. This was said with reference to the Presbyterian Church, and it is declared to be the doctrine applicable to all churches having a similar system of ecclesiastical government. The doctrine has been followed in many other cases and, although not accepted in England, it is the prevailing rule in this country.”

It is clear that because a Church follows the law of California and its spiritual body is governed by a spiritual organization and its property is held and managed by a Committee who holds that property in trust for religious purposes and is subservient to and

holds property and acts for the spiritual body, it is nevertheless an exempt organization in law, Section 101, Sub. 6. That the spiritual body may in its determination of ecclesiastical matters believe Christianity should be lived and it should be spread and taught by applying these teachings to everyday life so the public can witness them is hardly grounds for imposing a tax Congress did not intend.

These are matters of individual religious beliefs which one may or may not hold and if one holds them and joins a Church with similar beliefs Congress did not intend to tax one for one's religious beliefs as it results in the Riker and Grassmee cases.

CONCLUSIONS.

1. The donations by the appellant taxpayers to their Church with written statement accompanying each donation that the money was for religious purposes of the Church, were subject to the deduction of Section 23(o) as a gift to a religious organization. It also was a gift for the use of the religious purpose and created a fund or trust within Section 23(o).

2. The Elected Delegates Committee is an exempt organization within Section 101, Subdivision 6, as an organization exclusively organized and operated for religious purposes, no part of the income inuring to the benefit of any individual and no part of its activities being for propaganda or to otherwise influence legislation.

3. The fact the particular Church used so-called commercial activities as a laboratory for its student minister training and to carry the ministry of its teachings of Christianity to the public to show and illustrate that these teachings could be successfully applied to everyday life does not make it the less exempt.

a. The Church Constitution and Canon Laws require all money and property to be used solely and exclusively for religious purposes and contain many effective guaranties. The Church Committee accepted donations only with the written statement the money was for religious purposes.

b. The primary and sole purpose of the Church activities were religious. The so-called commercial activities were but a means to this religious purpose. It was merely incidental thereto. It was connected with and related to the religious purpose. The student ministers in these Church activities and ministry served without pay or compensation to carry out these religious purposes, religious training and their ministry.

4. Those in the full time work of this Church had the bare necessities provided them and their families to permit their full time study and work in their religious crusade. They lived in a religious apostolic society. Those who gave of their earnings to the Church's religious purposes are entitled to a Section 23(o) deduction. The common community treasury (Section 101, Sub. 18) organization filed its returns in the fiscal years involved as required by the regula-

tions and showed all their receipts, both the related income of Student Minister Training Application and donations from individuals. The members of this religious apostolic society each filed their income tax returns showing all monies passing through their hands and their pro-rata share of the apostolic society's income.

a. An officer or official of a local group who conducts a student minister training center and remits all related income to the Church should not be taxable upon these receipts as individual income. The arithmetical mistakes and omission of expenses of the related income and reimbursed by the Church Committee should not increase this net earnings of the group and increase the personal tax of this official.

b. When all members report their pro-rata share of the apostolic society's income, including gifts and are taxed thereon as a dividend, the donations included in this income should not be taxed both to the donor and to the members included in their pro-rata share upon the same money.

c. Members of an apostolic society should follow the customs and practices and regulations applicable to all others. They should report by family units and small children and old persons (aged 84 or 85) need not file separate returns upon penalty of losing their personal exemptions. The family group should return a separate dividend under Sub. 18 for each member.

The particular law applicable to Subdivision 18 of Section 101 is important as this is a test case for many

in the group and the decision will govern a number of pending matters (R. p. 74-76). It is a case of first impression.

Dated, San Francisco, California,
September 14, 1956.

HOWARD B. CRITTENDEN, JR.,
Attorney for Appellants.

